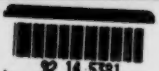

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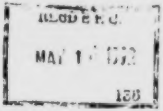
FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549



[X] Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 1992

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file Number 0-16109

ADVANCED POLYMER SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

| Delaware | 94-2875566 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |

3696 Haven Avenue, Redwood City, CA 94063
(Address of principal executive offices)

(415) 366-2626
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

At April 30, 1992, the number of outstanding shares of the Company's common stock, par value $.01, was 12,107,169.

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PART I.
ITEM 1.

ADVANCED POLYMER SYSTEMS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

| | March 31, 1992 | December 31, 1991 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $4,848,789 | $1,572,396 |
| Marketable securities | 6,522,543 | 1,207,935 |
| Trade accounts receivable, net | 607,670 | 334,141 |
| Receivable from Rhone-Poulenc Rorer | 0 | 796,238 |
| Inventory, net | 812,325 | 510,256 |
| Other current assets | 218,829 | 283,172 |
| Total current assets | 13,010,156 | 4,704,138 |
| Property and equipment, net | 4,264,468 | 3,160,169 |
| Pledged long-term marketable securities | 1,461,857 | 1,417,544 |
| Prepaid license fees | 736,250 | 100,000 |
| Goodwill | 803,983 | 0 |
| Other assets | 211,487 | 213,441 |
| | $20,488,201 | $9,595,292 |
| **LIABILITIES & SHAREHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 320,236 | $ 690,273 |
| Other current liabilities | 846,294 | 250,303 |
| Deferred taxes | 2,678 | 2,678 |
| Advance from Rhone-Poulenc Rorer | 0 | 1,500,000 |
| Total current liabilities | 1,169,208 | 2,443,254 |
| Long-term debt | 3,995,174 | 4,000,000 |
| Total liabilities | 5,164,382 | 6,443,254 |
| Minority interest-Advanced Consumer Products | 0 | 81,485 |
| Shareholders' equity: | | |
| Common stock and common stock warrants | 44,643,490 | 30,484,478 |
| Accumulated deficit | (29,319,671) | (27,413,925) |
| Total shareholders' equity | 15,323,819 | 3,070,553 |
| | $20,488,201 | $9,595,292 |

See accompanying notes.

ADVANCED POLYMER SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | 3 Months Ended March 31, 1992 | 3 Months Ended March 31, 1991 |
|---|---|---|
| Product sales | $ 254,158 | $ 150,026 |
| Supply contracts | 343,326 | 110,363 |
| Licensing agreements | 95,000 | 135,000 |
| Total revenues | 692,484 | 395,389 |
| Cost of sales | 668,943 | 401,033 |
| Gross profit | 23,541 | (7,644) |
| Research & development | 957,354 | 603,398 |
| Selling and marketing | 183,073 | 140,099 |
| Advertising and promotion | 149,561 | 0 |
| General & administration | 769,330 | 407,350 |
| Total operating expenses | 2,059,318 | 1,150,847 |
| Minority interest | 44,740 | 0 |
| Interest income | 122,035 | 103,880 |
| Interest expense | (75,570) | (76,767) |
| Loss before taxes | $(1,944,572) | $(1,131,378) |
| Taxes | (38,826) | 5,300 |
| Net loss | $(1,905,746) | $(1,136,678) |
| Loss per common share | $(0.17) | $(0.12) |
| Weighted average common shares outstanding | 11,185,665 | 9,708,923 |

See accompanying notes.

ADVANCED POLYMER SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
for three month March 31, 1992 and 1991
(Unaudited)

| | 3 Months Ended March 31, 1992 | 3 Months Ended March 31, 1991 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $ (1,905,746) | $(1,136,678) |
| Adjustments to reconcile net loss to net cash used by operating activities: | | |
| Depreciation and amortization | 194,274 | 196,198 |
| Charge for purchase of R&D in process | 106,636 | 0 |
| Provision for losses on accounts receivable | (40,000) | (20,000) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (233,529) | 107,631 |
| Accounts receivable from RPR | 796,238 | 50,604 |
| Inventory | (302,070) | 121,502 |
| Prepaid license fees | (636,250) | 0 |
| Other assets | 80,918 | 69,163 |
| Current liabilities | (274,046) | (196,167) |
| Total adjustments | (327,829) | 328,731 |
| Net cash from operating activities | (2,233,575) | (807,947) |
| Cash flows from investing activities: | | |
| Purchase of fixed assets | (66,214) | (15,723) |
| Loss on disposal of fixed assets, net | 3,267 | 4,927 |
| Change in marketable securities | | |
| Accretion of long-term marketable securities | (5,314,608) | 1,447,161 |
| Minority interest - Advanced Consumer Products | (44,313) | (25,034) |
| Repayment of long-term debt | (44,740) | 0 |
| | (4,826) | 0 |
| Net cash provided from investing activities | (5,471,434) | 1,411,331 |
| Cash flows from financing activities: | | |
| Proceeds from the exercise of common stock options, net of shares retired | 334,547 | 6,750 |
| Private placement | 8,646,855 | 0 |
| Restructuring of Rhone-Poulenc Rorer agreement | 2,000,000 | 0 |
| Net cash provided from financing activities | 10,981,402 | 6,750 |
| Net increase in cash and cash equivalents | 3,276,393 | 610,134 |
| Cash and cash equivalents, beginning of the period | 1,572,396 | 1,744,734 |
| Cash and cash equivalents, end of the period | $4,848,789 | $2,354,868 |

See accompanying notes.

ADVANCED POLYMER SYSTEMS, INC.
Notes to Condensed Consolidated Financial Statements
March 31, 1992 and 1991
(Unaudited)

(1) BASIS OF PRESENTATION

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position as of March 31, 1992, and the results of operations and changes in cash for the three months ended March 31, 1992 and 1991.

These condensed consolidated statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 1991, 1990, and 1989, which are included as part of the Company's 1991 Annual Report to stockholders and Annual Report on Form 10-K.

Although the nature of the business is not seasonal, the results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year.

The consolidated financial statements include the financial statements of the Company (APS) and its subsidiaries, Advanced Consumer Products Inc., and APS Joint Venture Corporation. All significant intercompany balances and transactions have been eliminated in consolidation.

Certain reclassifications have been made to the prior year financial statements to conform with the presentation in 1992.

(2) PROPERTY AND EQUIPMENT

Details of the Company's property and equipment are as follows:

| | March 31, 1992 | December 31, 1991 |
|---|---|---|
| Leasehold improvements | $ 462,748 | $ 462,748 |
| Furniture and equipment | 6,260,233 | 6,210,034 |
| Building | 1,789,814 | 759,569 |
| Land and improvements | 363,519 | 163,519 |
| | $8,876,314 | $7,595,870 |
| Accumulated depreciation | (4,611,846) | (4,435,701) |
| | $4,264,468 | $3,160,169 |

(3) COMMON SHARES OUTSTANDING AND PER SHARE INFORMATION

Common stock outstanding as of March 31, 1992 is as follows:

| | Number of Shares |
|---|---|
| Common stock outstanding as of December 31, 1991 | 9,998,531 |
| Options exercised after December 31, 1991 | 100,553 |
| Shares retired to exercise options | (4,850) |
| Shares issued in conjunction with: | |
| Private placement | 1,150,000 |
| Restructuring of Rhone-Poulenc Rorer agreement | 705,041 |
| Acquisition of the minority interest in Advanced Consumer Products | 157,894 |
| TOTAL SHARES | 12,107,169 |

Per share information is based on the weighted average of common stock outstanding, as so adjusted during each of the periods. Stock options and warrants (common stock equivalents) are not included in the calculations as their inclusion would be anti-dilutive.

(4) RHONE-POULENC RORER

In May 1989, APS established a wholly-owned subsidiary, APS Joint Venture Corp. ("APS JV"), which entered into a series of agreements with Rhone-Poulenc Rorer ("RPR") and certain of its affiliates for the development, manufacture and marketing of products in the ethical dermatology field. Under the agreements, a general partnership was established and RPR committed to fund, as needed, as permanently invested capital, product development efforts and the costs of a melanin production facility up to a total of $5,750,000. Expenditures in excess of the agreed upon permanent capital contribution would continue to be funded by RPR, with APS JV to reimburse its share of such excess from a portion of any future cash flows of the partnership. The partnership initially focused its efforts on Melanosponge®, unique sun protection products that use genetically-engineered melanin entrapped in Microsponge® delivery systems, and began development of several other dermatological applications.

APS contributed license rights to certain patents to the partnership which had a zero book value. No other capital contributions were made by APS. Since APS carried its investment in the joint venture at zero and was not required to make future cash contributions, the Company did not recognize losses attributable to its 50% equity position in the partnership.

In March, 1992, APS and RPR restructured their agreements. Under the new arrangement, RPR conveyed to the Company its entire interest in the partnership (on which it had expended approximately $4,562,000), invested $2.0 million in cash for APS common stock, and relieved APS of its obligation to repay $1.5 million it advanced the Company in 1991. As part of the

transaction, APS gained ownership of the manufacturing facility under construction by the partnership and funded by RPR. In return, RPR received 705,041 shares of unregistered (subject to certain registration rights) and restricted APS common stock and a 30 day warrant to purchase up to an additional 1,000,000 shares at $9.50 per share, which was not exercised. RPR is continuing to fund the development of three dermatology products under the revised agreements, to which APS shares marketing rights, while all other rights in ethical dermatology, including all ownership rights to the use of the Melanosponge system revert to APS. RPR will continue to share in a portion of the future profits of sales from Melanosponge systems as presently formulated.

In 1992, through the date of the restructuring of the partnership agreements, the Company has billed RPR $90,000 for research and development expenses incurred in conjunction with partnership projects. All outstanding receivables were paid by RPR in March 1992.

(5) ADVANCED CONSUMER PRODUCTS

In 1991, APS incorporated Advanced Premier Products (APP) to market products using APS' patented Microsponge delivery systems in eight specific over-the-counter skin care fields. APP was owned 75% by APS and 25% by Premier, Inc., a marketing company. In February, 1992, APS acquired the outstanding 25% minority interest in APP for 157,894 shares of common stock, 78,947 of which were issued to John J. Meakem Jr., the President and Chief Executive Officer of APS and Chairman of Premier, Inc.. The acquisition of Premier's minority interest resulted in APS recording of $803,983 of goodwill. The name of the subsidiary was changed to Advanced Consumer Products ("ACP"). Premier will continue to direct the marketing and sales activities of ACP, under a newly executed agreement.

In June 1991, a non-refundable payment of $1 million was received by ACP from Johnson & Johnson Consumer Products, Inc. ("J&J CPI"). In return, J&J CPI has rights to purchase product lines or lines of business from ACP in the fourth and sixth year after product introduction for a predetermined multiple of sales.

Commercial sales of ACP's first product, EveryStep™, a daily use, odor-fighting foot powder containing Microsponge entrapments, began in the first quarter of 1992. Net sales for the period were $66,000.

(6) DOW CORNING

In July, 1991, APS and Dow Corning Corporation formed a collaborative alliance to manufacture and sell both APS' Microsponge and Dow Corning's Polytrap® technologies worldwide in the cosmetics and toiletries field. The arrangement provides that the current APS Microsponge and the Dow Corning Polytrap cosmetic and toiletry sales are to be included in the alliance.

APS is contributing its technology, research and development, technical support, and manufacturing capability and capacity for both the Microsponge and Polytrap products. Dow Corning has advanced APS $1 million and is supplying sales coverage and world-wide marketing support with its 60 person sales force. Dow Corning and APS share the gross profits of the venture equally. Revenues for the first quarter of 1992 totaled $77,000.

(7) PRIVATE PLACEMENT

In February, 1992, APS raised $8,658,000 net of offering costs, through a private placement and sale of 1,150,000 units of one share of common stock and one warrant to purchase common stock. The placement agent received 11,500 warrants in the transaction. The 1,161,500 warrants are exercisable for three years at $8.80 per share. The shares offered are not registered under the SEC Act of 1933. However, APS is obligated to register the shares after a request is received by 10% or more of the holders of the units, at any time after 180 days after closing.

(8) JOHNSON & JOHNSON INVESTMENT AND LICENSE AGREEMENTS

In May, 1992, the Company announced a licensing agreement with Ortho Pharmaceutical Corporation, a subsidiary of Johnson & Johnson Inc., for retinoid-based products incorporating APS' patented Microsponge delivery system. As part of the agreement, Johnson & Johnson purchased $4 million of newly issued APS common stock - 354,767 shares at a price of $11.275 per share - and Ortho paid a license fee of $2 million to APS. Subject to certain conditions, Ortho will make an additional license payment of $4 million and Johnson & Johnson will purchase an additional $4 million of APS common stock in September 1992. Ortho is also obligated to pay to APS an additional substantial amount on achievement of specified milestones.

The license agreement provides Ortho with exclusive distribution or license rights for certain retinoid products utilizing the APS Microsponge system. Ortho currently markets Retin-A™ - in which the active ingredient is Tretinoin - for the treatment of acne. Ortho may elect to terminate the license agreement at any time prior to September, 1992, and thereafter on one year's notice. In that event, no further license fees or milestone payments would be payable by Ortho, and all amounts paid to APS to that point would be non-refundable.

Under the license agreement, APS will receive a royalty on net sales of all Ortho's retinoid products that incorporate APS's Microsponge technology. Ortho's exclusivity will continue as long as certain annual minimum royalty payments are made. In addition, Ortho will pay license fees and milestone payments referred to above over time to APS, triggered by specified achievements for two Tretinoin-based products including the acne product already under development. The milestone achievements include the filing and completion of NDAs for both products.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollar amounts are rounded to nearest $1,000)

Results of Operations for the three months ended
March 31, 1992 and 1991

Total revenues of $693,000 for the three months ended March 31, 1992, increased 75% from the comparable period of the prior year. Analytical Standards sales increased 25% to $188,000 and supply contract sales of $343,000 were up 211% due to production for Lancaster Group AG and Dow Corning Corporation. Licensing revenues of $95,000 declined from $135,000 in the prior year due to the planned reductions in fees from certain licensing agreements and the reacquisition by the Company of product rights from its licensees in fields where no active research was being performed. EveryStep™ foot powder was introduced during this quarter with total net sales of $66,000.

Cost of sales for the quarter of $669,000 was 66% more than the prior year, primarily due to an increase in Analytical Standard sales, costs of polymer supplied to Dow Corning Corporation and Lancaster Group AG, and costs associated with the sales of EveryStep foot powder. Cost of sales also included overhead costs of the Company's production facility in Lafayette, Louisiana.

Research and development expenses increased $354,000 (59%) from the comparable period of the prior year due to the one-time charge of $107,000 for research and development projects in process acquired through the purchase of the minority interest in Advanced Consumer Products, and costs of clinical studies associated with the new drug applications for Company's proprietary products.

Selling and marketing expenses increased $43,000 (31%) from the comparable period of the prior year due to one additional salesperson in the Analytical Sales department and higher analytical standard sales, and expenses associated with the introduction of EveryStep foot powder.

Advertising and promotion expenses were incurred in conjunction with the introduction of EveryStep foot powder.

General and administration expenses increased $362,000 (89%) primarily due to legal fees incurred during litigation of the Patterson trial, and fees paid to Premier, Inc. for the management of the Company's Advanced Consumer Products subsidiary.

Interest income increased $18,000 (18%) from the comparable period in the prior year because of higher cash equivalents balances in 1992.

The net loss of $1,906,000 for the quarter ($0.17 per share) was 68% greater than the $1,137,000 loss ($0.12 per share) in the first quarter of 1991. The Company expects that operating losses will continue as it funds clinical studies for its proprietary products and until it realizes large-scale commercialization of licensed or proprietary products by the Company and its clients.

It is anticipated that operating results will fluctuate on a quarterly basis due to the timing of the fulfillment of supply contracts, realization of milestone payments based on the achievement of specific events, the addition or termination of research and development agreements and variations in the level of expenditures relating to research and development of the Company's proprietary products.

Liquidity and Capital Resources

The Company continues to finance its operations from funds on hand, sales of the Company's own consumer products, sales of polymer products under supply contracts, revenues from Analytical Standard product sales, interest earned on short-term investments, sales of equity securities and payments received under licensing and research agreements.

On March 31, 1992, the Company had $11,371,000 in cash, cash equivalents and short-term marketable securities. Included in this amount are $8,658,000 received in February, 1992 from the private placement and $2,000,000 received in March, 1992 as part of the restructuring of the RPR agreement. The $2 million licensing payment by Ortho Pharmaceutical Corporation and the $4 million equity investment by Johnson & Johnson received in May, 1992, are not included in the cash balances as of March 31, 1992.

Based on the Company's current plan of operations, the existing cash, cash equivalents and short-term marketable securities balances, together with funds generated from operations and the sale of equity securities, are expected to be sufficient to meet the Company's cash requirements.

The Company's cash reserves are invested in short-term high-grade investments and will continue to be used as needed for research on new applications and systems, product development including clinical testing of completed products, manufacturing and marketing of proprietary formulations and for general corporate purposes.

PART II.

Item 1. Legal Proceedings

In January, 1984, the Company converted a prior royalty-bearing agreement with James A. Patterson, a founder, shareholder and former employee of APS, who then owned approximately 21% of the Company's stock, into an agreement to acquire his inventory of Analytical Standards chemical concentrates and the related patent rights in exchange for a maximum of 140,000 shares of APS common stock to be issued over a period of five years, based on the level of Analytical Standards sales achieved in each of the five years. During the years ended December 31, 1988, 1987 and 1986, APS did not achieve the Analytical Standard sales levels required by the agreement to issue shares of common stock to the stockholder. In 1985, 14,000 shares were issued under the agreement. No other shares were issued under the agreement.

On January 18, 1989, Patterson filed a lawsuit against the Company alleging breach of the 1984 agreement. The suit was filed in the State of Florida Circuit Court and seeks recission of the 1984 agreement or damages in an unspecified amount. Trial of this action took place in January, 1992, but no decision has yet been rendered.

In July 1991, Patterson filed a second lawsuit against the Company in the United States District Court, Middle District of Florida. A former director and an employee of the Company were also named as defendants. In his complaint, Patterson claims that among other things, he was fraudulently induced to enter into an employment agreement with the Company as part of a conspiracy to steal a cosmetic invention for which he had applied for a patent. The employment agreement was part of a series of transactions under which Patterson sold to the former director his rights in the cosmetic invention patent application. Patterson also claims that inventorship of the process which was the subject of the patent application was claimed by the Company's employee in his subsequent patent application, instead of reflecting Patterson as the inventor or a co-inventor. Compensatory damages in excess of $50,000 and punitive damages of $20,000,000 are claimed.

The agreement in question contains an arbitration clause, and the Company has invoked that provision and referred the dispute to the American Arbitration Association, but it is uncertain whether the matter will proceed by court action or arbitration. The Company has denied liability and is defending the claims. Various affirmative defenses have been raised, including defenses based on the statute of limitations and on a release given by Patterson. In addition, the Company is not aware of any facts which would support an award of punitive damages. The Company does not believe that this lawsuit will have a material impact on either the operations or financial condition of the Company.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits: None
(b) Reports on Form 8-K. During the quarter ended March 31, 1992, no reports on Form 8-K have been filed.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ADVANCED POLYMER SYSTEMS, INC.

Date: 5/13/92

By: _____
John J. Makem, Jr.
President and Chief Executive Officer

Date: 5/13/92

By: _____
Bennet L. Weintraub
Controller